THE KA WAH BANK LTD

v.

HONG LEONG BANK BHD & ORS

COURT OF APPEAL, KUALA LUMPUR
SHAIK DAUD ISMAIL JCA
MOKHTAR SIDIN JCA
HAIDAR MOHD NOOR JCA
[CIVIL APPEAL NO: W-02-236-1996]
24 AUGUST 2000

BANKING: *Banking business - Letter of credit - Entitlement to proceeds of securities pledged - Doctrine of subrogation - Agreement*

The first and second respondents granted a syndicated term loan of RM30m to the fourth respondent in 1985. As consideration the fourth respondent pledged some shares to the second respondent. The fourth respondent also applied for an irrevocable standby letter of credit from the appellant and executed a letter of indemnity and counter-guarantee in favour of the appellant. The appellant then issued the letter of credit in favour of the first respondent.

When the fourth respondent defaulted on the loan the first respondent made a demand on the appellant who duly paid up. In making that payment the appellant informed the first respondent that it stood in the position of a surety and as such was entitled to the shares pledged subject to the first and second respondents' rights against the fourth respondent. The appellant then demanded that the dividends of the shares be paid by the first respondent to the appellant but the demand was not met.

The appellant then brought an action claiming that it was entitled to the dividends by way of express agreement between it and the fourth respondent and by the doctrine of subrogation. The trial judge found against the appellant and hence the instant appeal.

Held:
Per Mohktar Sidin JCA:

[1] When the appellant paid the first respondent, it had informed the latter that it now stood in the position of a surety. By right, the fourth respondent or the third respondent should have forwarded the shares to the appellant when the payment was made by the appellant as security.

[2] When the fourth respondent failed to deliver the shares to the appellant, it had defaulted in its undertaking and had withheld the shares unlawfully.

[3] From the evidence the primary liability in the instant appeal was upon the fourth respondent and the secondary liability was upon the appellant. As from the date of payment the appellant stepped into the shoes of the first respondent and became the main creditor. The appellant clearly had the right of subrogation and was entitled to all the benefits accruing from the shares and this included any dividends paid after that date and as such the dividends should be paid to the appellant.

[Appeal allowed.]

*[**Bahasa Malaysia** Translation Of Headnotes]*

Responden pertama dan kedua memberikan satu pinjaman berjangka sejumlah RM30 juta kepada respondent keempat dalam tahun 1985. Sebagai balasan responden keempat telah menyandarkan saham-saham kepada responden kedua. Responden keempat juga memohon satu surat kredit takboleh batal dari perayu dan menyempurnakan satu surat tanggungrugi dan gerenti berbalas memihak kepada perayu.

Apabila responden keempat memungkiri pinjaman tersebut, defendan pertama menuntut jumlah tersebut dari perayu. Perayu membayarnya. Semasa membuat bayaran perayu memberitahu responden pertama bahawa ia adalah penjamin dan dengan itu berhak kepada saham-saham yang disandarkan tertakluk kepada hak-hak responden pertama dan kedua terhadap responden keempat. Perayu menuntut yang dividen-dividen saham-saham tersebut dibayar oleh responden pertama kepada perayu tetapi tuntutan ini tidak dipenuhi.

Perayu membawa tindakan ini mendakwa bahawa ia berhak kepada dividen-dividen melalui perjanjian nyata di antara mereka dengan responden keempat dan melalui doktrin subrogasi.

Diputuskan:
Oleh Mokhtar Sidin HMR:

[1] Apabila perayu membayar responden pertama, ia telah memberitahu beliau bahawa ia sekarang ini adalah penjamin. Secara betul, responden keempat dan ketiga patut menghantar saham-saham tersebut kepada perayu apabila bayaran dibuat oleh perayu sebagai jaminan.

[2] Apabila responden keempat gagal menghantar serah saham-saham tersebut kepada perayu, ia telah memungkiri akujanji dan telah menahan saham-saham tersebut menyalahi undang-undang.

[3] Dari keterangan liabiliti primer dalam rayuan semasa adalah pada responden keempat dan liability kedua pada perayu. Bermula dari tarikh bayaran perayu mengambil alih tempat responden pertama dan menjadi pemiutang utama. Perayu dengan jelasnya mempunyai hak subrogasi dan berhak kepada kesemua faedah-faedah yang terakru dari saham-saham tersebut dan ini termasuklah sebarang dividen yang dibayar selepas dari tarikh tersebut dan dari itu dividen patutlah dibayar kepada perayu.

[Rayuan dibenarkan dengan kos.]

Case(s) referred to:

Duncan, Fox, & Co and Robinson & Co v. The North and South Wales Bank, SC Radford, Radford & Sons, and Balfour, Williamson, & Co [1880] VI App Cases 1 ***(refd)***

For the appellant - Ira Biswas; M/s Chooi & Company
For the respondent - Manjit Singh (Balvinder Singh Kenth with him); M/s Sri Ram & Co

[Appeal from High Court, Kuala Lumpur; Originating Summons No: C3-31-369-86]

Reported by Yow Ting Fong

JUDGMENT

Mokhtar Sidin JCA:

The facts in respect of this appeal are as follows.

On 29 September 1985, Malayan United Bank Berhad (now known as Hong Leong Bank Berhad) (the first respondent) and Malayan United Finance Berhad (the second respondent) granted a syndicated term loan of RM30 million to Nadinusa Sdn Bhd (the fourth respondent). In consideration of the facility given by the first and second respondents, the fourth respondent pledged its 4,050,000 Supreme Finance (M) Bhd shares (hereinafter referred to as "the shares") to the second respondent which was subsequently transferred to MUBB Nominees Sdn Bhd (the third respondent). In addition, Supreme Corporation Berhad pledged another 4,050,000 Supreme Finance (M) Bhd shares to the second respondent. The Minister of Finance gave his consent to the first pledge, but refused consent to the pledge by Supreme Corporation Berhad. Due to this refusal the charge by Supreme Corporation Berhad never took place. As a result of this the fourth

respondent on 24 January 1986 applied from Ka Wah Bank (the appellant) an irrevocable standby letter of credit. As a consideration for that facility the fourth respondent executed a letter of indemnity and counter guarantee in favour of the appellant on 24 January 1986.

On 31 January 1986 the appellant issued the letter of credit in favour of the first respondent. This letter of credit was subjected to Uniform Customs and Practice for Documentary Credits 1983, Revision.

The fourth respondent defaulted on the loan facility given by the first respondent. The first respondent then demanded from the appellant payment for the sum as stated in the letter of credit. On 24 July 1986 the appellant paid the sum demanded. In making the payment the appellant informed the first respondent that the appellant now stood in the position of a surety and as such was entitled to the shares subjected to the first and second respondents' rights against Nadinusa. This was not disputed. On 24 September 1986 the first respondent wrote to the fourth respondent stating that it had received dividends amounting to RM607,500 paid by Supreme Finance (M) Bhd on the shares (hereinafter referred to as "the dividends") which were paid on 20 August 1986. A copy of the letter was extended to the appellant. On 21 October 1986 the appellant demanded from the first respondent that the dividends be paid to them. When the first respondent failed to comply with the said demand the appellant took the present originating summons seeking the following:

(1) A declaration that the appellant stands in the position of a surety or alternatively, in a position analogous to that of a surety under the standby letter of credit No. HOSLC 860001 for the sum of RM31,250,000 (hereinafter referred to as "the said letter of credit") issued by the appellant in favour of the first respondent as security for a term loan of RM30,000,000 granted by the first and second respondents in favour of the fourth respondent.

(2) A declaration that the appellant as a surety or alternatively, standing in the position analogous to that of a surety is entitled upon honouring the said letter of credit by effecting payment in full to the first and second respondents, to be subrogated to the rights of the first and second respondents under the principal loan agreement dated 20 September 1985 entered into between the fourth respondent and the first and second respondents.

(3) A declaration that the appellant as subrogatee is entitled to the benefit of the securities deposited and/or listed under said principal loan agreement namely:

(a) the 4,050,000 shares in Supreme Finance (M) Berhad respondent;

(b) the 4,050,000 shares in Supreme Finance (M) Berhad pledged by Supreme Corporation Berhad;

(c) a corporate guarantee by Supreme Corporation Berhad; and

(d) the guarantee and/or guarantees executed by Hashbudin bin Hashim (NRIC No. 4174400), Megat Majid bin Megat Ayob (NRIC No. 4503227); and Anuar bin Othman (NRIC No. 4506820).

(4) A declaration that the 4,050,000 shares in Supreme Finance (M) Berhad referred to in para (3)(a) above and registered in the name of the third respondent as nominee shall be held by the third respondent on behalf of and for the benefit of the appellant;

(5) A declaration that the appellant shall be entitled to receive the dividends of RM607,500 paid on the 4,050,000 shares in Supreme Finance (M) Berhad referred to in paragraph (3)(a) above;

(6) An order that the first and second respondents should execute all such documents and do all whatsoever acts matters and things necessary to give effect to the appellant's rights of subrogation and the appellant's rights as subrogatee to the benefit of the securities deposited and/or listed under the said principal loan agreement.

It is clear to us that the first, second and third respondents are not interested in the outcome of this appeal and as to whom the dividends should be paid. The dispute as to who is entitled to the dividends is between the appellant and the fourth respondent. We were informed that the dividends had been deposited in court pending the outcome of this appeal.

We were informed by the parties that, apart from the present appeal, there were several other suits between the appellant and fourth respondent came to an agreement in respect of the other suits. Subsequently, the appellant disputed that there was a binding settlement between the parties. As a result of this denial by the appellant, in November 1988, the fourth respondent and one Hashbudin (a director and shareholder of the fourth respondent) filed suit No. D4-22-224-88 which was heard by Dr Zakaria Mohd Yatim J. (as he then was) and on 3 December 1993 he decided in favour of the fourth respondent and the said Hashbudin. The learned judge there found that the agreement in May 1988 between the appellant and the fourth respondent was valid and ordered specific performance of that agreement. Amongst others, the terms of the settlement were:

(a) that Nadinusa would deposit its SF share certificates and transfer forms to Ka Wah Bank whereupon Ka Wah Bank would withdraw all pending actions (including the present appeal); and

(b) upon Nadinusa's depositing the said shares and duly executed transfer forms, Ka Wah Bank is entitled to retain all benefits securing from the above stated shares from 20.5.1988.

Apparently, the appellant was not happy with that decision especially the one in para (b) and it appeled to the Federal Court.

When the appeal against the decision of Dr. Zakaria Mohd. Yatim J. to the Federal Court was still pending, the application by the fourth respondent in the present appeal was heard by another judge (the trial judge in the present appeal). Before the learned trial judge the appellant claimed that the above-stated order did not include the dividends. The order did not touch on the dividends which were left open. That being the case the appellant is still entitled to the dividends. As such the appellant is entitled to the declaration as stated earlier. On the other hand, the fourth respondent claimed that the order of Dr Zakaria Mohd Yatim J. made it clear that the appellant is only entitled to the benefits under those shares (including dividends) accruing after **20 May 1988**. Any benefit prior to that date belonged to the fourth respondent. Since the dividends were paid on 20 August 1986, they rightly belonged to the fourth respondent. That is the main issue in this case.

The learned trial judge in the court below found in favour of the fourth respondent and dismissed the appellant's claim. In his judgment the learned trial judge said:

> Once again, with respect, I disagree. Regarding para (2), no doubt there was no specific mention that the dividend be paid to any party, but the learned Judge did hold that the letter which concluded the negotiation was the letter dated 20.5.1988, wherein one of the terms stated was upon Nadinusa depositing the said shares and the duly executed transfer forms, Ka Wah Bank is entitled to retain all benefits accruing to the said shares from the date thereof. Therefore even though there was no specific order on the dividend, there was an express term of the settlement that Ka Wah Bank would be entitled to the benefits from the date 20.5.1988, and by necessary implication, Ka Wah Bank would not therefore be entitled to any benefits prior to that date. If Ka Wah Bank is not entitled to the dividend, I would hold that Nadinusa is, and in so holding, I do not think it goes beyond the judgment of Justice Zakaria.

Against that decision the appellant have now appealed to this court. Before the appeal was heard the Federal Court gave their decision. It was contended by counsel for the appellant that the learned trial judge had erred when he made his decision based on the decision of Dr Zakaria Yatim J. As a matter of interest part of that decision had been overruled by the Federal Court. To be fair to the learned trial judge when he gave his decision he had before him only the judgment of Dr Zakaria Mohd Yatim J. The Federal Court gave their decision after the learned trial judge gave his decision. As such when the learned trial judge gave his decision in 1996, he was not aware than part of Dr Zakaria Mohd Yatim's decision had been overruled. Peruring the judgment of the Federal Court it is clear to us that the Federal Court reversed the decision of Dr Zakaria Mohd Yatim J. in respect of the benefits arising from where it was held that there was no settlement in respect of the benefits arising from the shares. Looking at the judgment of the learned trial judge cited above it is clear to us that his decision was on the premise that there was a settlement in respect of the benefits arising from the shares as decided by Dr Zakaria Mohd Yatim J. Since the Federal Court had held that there was no such settlement, the basis upon which the learned trial judge gave his decision had been nullified. As such his decision is no longer valid.

In view of what is stated above, it is clear to us that this court has to evaluate the evidence as a whole. The court has to disregard the judgment of the learned trial judge.

As we understand it, counsel for the appellant contended that the appellant has the right over the dividends because of the following grounds:

(a) There was an express agreement between the appellant and the fourth respondent whereby the fourth respondent were to hand over the shares which were pledged to the first respondent, in the event the appellant had to pay the first respondent under the letter of credit; and

(b) by the doctrine of subrogation.

Counsel for the appellant referred to a letter dated 7 October 1985 which reads as follows:

October 7, 1985

The Ka Wah Bank Ltd
232 Des Voeux Road Central
Hong Kong.

Dear Sir,

Re: 4,050,000 shares in Supreme Finance (M) Bhd.

> With reference to the Standby L/C for MYR31,250,000.00 issued by your Bank in favour of Malayan United Bank Bhd, we hereby undertake to deposit with you as securities the 4,050,000 shares of the Supreme Finance (M) Bhd which we previously authorized you to release to and deposit with Malayan United Bank Bhd in the event of any claims by the Malayan United Bank Bhd under the said Standby L/C.
>
> Sgd.

It is clear to us that the shares mentioned in the letter are the shares pledged to the first respondent. As we have stated that the event had taken place, that is the first respondent who had demanded and the appellant had paid the first respondent the sum guaranteed by the letter of credit on 24 July 1986. The appellant, when they paid the amount demanded, informed the first respondent that they now stood in the position of surety. By right, the fourth respondent or the third respondent should have forwarded the shares to the appellant when the payment was made by the appellant as security. That was the undertaking given by the fourth respondent in the above-stated letter. The shares were never given to the appellant until Dr Zakaria Mohd Yatim J. made the order to do so on 3 December 1993. It is clear to us that when the fourth respondent failed to deliver the shares to the appellant, they have defaulted in their undertaking and had withheld the shares unlawfully.

From the events that took place it is not disputed that the appellant pursuant to the letter of credit, paid the first respondent the amount guaranteed given under that letter of credit on 24 July 1986. The shares should have been forwarded to the appellant as security on that date or soon afterwards. The relevant parties and authorities should have been informed of the status of the shares. None of this took place. It was not clear in whose possession the shares were but from the judgment of Dr Zakaria Mohd Yatim J. it could be inferred that the shares were in the possession of the fourth respondent. This is further strengthened by the fact that when the first respondent received the dividends on 2 September 1986 they informed the fourth respondent that the shares had been returned to the fourth respondent. If the shares were handed to the appellant in accordance with the undertaking and the various parties or authorities had been informed of that, it is most likely that the dividends would be paid to the appellant. The date of payment of the dividends was 20 August 1986 which was about a month after the appellant made the payment pursuant to the letter of credit. By right the appellant should have become the owner of the shares on 24 July 1986 and whatever benefits accruing from the shares after that date belonged to the appellant. On the facts it is clear to us that by 24 July 1986 the shares should be in the hands of the appellant as security and whatever benefits should be paid to the appellant.

As we have stated earlier, the shares were not handed to the appellant as security. It was not known in whose hand the shares were. By virtue of the letter by the appellant informing the first respondent that they were stepping into the shoes of the first respondent as surety, the appellant had established the right of subrogation as from that date. In *Duncan, Fox, & Co and Robinson & Co v. The North and South Wales Bank, SC Radford, Radford & Sons, and Balfour, Williamson, & Co* [1880] VI App Cases 1, in December 1874, one of the partners of SR & Sons deposited with the N & SW Bank the title deeds of two of his own freehold properties, and signed a memorandum acknowledging them to be deposited as securities for what the N & SW Bank might advance to the firm in the way of discounts. In November 1875, D & Co sold to R & Sons a cargo of corn to be paid for in cash. Cash was paid only for part. R & Sons offered a bill of exchange for the rest, which was declined. D & Co were customers of the N. & SW Bank R & Sons said if D & Co would inquire of those bankers they would find it would be all right with the R & Sons' bills. The bank manager refused to discount the bill without the indorsement of D & Co, but said that he believed D & Co would incur no more than a nominal liability by putting their names on the bill. D & Co thereupon consented to take the bill, indorsed it in the ordinary way, and it was discounted by the bank and carried to their credit. In January 1876, R & Sons stopped payment. The bill became due in February, and was dishonoured. D & Co, who then became acquainted with the fact that securities had been deposited with the bankers to cover advances on R & Sons' bills, brought an action against the N & SW Bank to have the benefit, so far as they would go, of the securities deposited in December 1874, claiming to be sureties to the bankers for what was due upon the bill. It was held by the House of Lords that D & Co were sureties on the bill, and that as such they were entitled to the benefit of these securities. At pp. 10 and 11 Lord Selborne, LC said:

> The question, therefore, as to the proper appropriation of the remaining securities, is between the Respondents, claiming in right of *Samuel Collins Radford* (one of the acceptors), and the Appellants, the indorsers of the bill of exchange; and it ought, I conceive, to be determined upon the same principles as if the Appellants had actually paid the bills, and as if the bank had paid the proceeds of the securities either to the Appellants, or into Court in this action. If in either of those events, *Samuel Collins Radford* would have been entitled to an order against the Appellants for repayment, or for payment out of Court of such proceeds, to be applied as part of his estate under the inspectorship deed, your Lordships' judgment ought now to be for the Respondents; if not, the Appellants are right. The Vice-Chancellor of the Palatine Court of *Lancaster* thought that the Appellants were right; and, with the utmost respect to the Court of Appeal (which thought otherwise), I am of the same opinion.

> In examining the principles and authorities applicable to this question, it seems to me to be important to distinguish between three kinds of cases: (1.) Those in which there is an agreement to constitute, for a particular purpose, the relation of principal and surety, to which agreement the creditor thereby secured is a party; (2.) Those in which there is a similar agreement between the principal and surety only, to which the creditor is a stranger; and (3.) Those in which, without any such contract of suretyship, there is a primary and a secondary liability of two persons for one and the same debt, the debt being, as between the two, that of one of those persons only, and not equally of both, so that the other, if he should be compelled to pay it, would be entitled to reimbursement from the person by whom (as between the two) it ought to have been paid.

It is clear to us that the present appeal falls within the third category stated above. From the evidence the primary liability in the present appeal was upon the fourth respondent and the secondary liability was upon the appellant. Thus when the first respondent demanded payment from the appellant under the standby letter of credit, the appellant complied. This took place on 24 July 1986. In our view as from that date the appellant stepped into the shoes of the first respondent and became the main creditor. The appellant had clearly the right of subrogation. That being the case the appellant were entitled to all the benefits accruing from the shares and this includes any dividends should be paid to the appellant.

For the reasons we have stated above, we are of the view that the appellant is entitled to those dividends and accordingly we allowed the appeal with costs here and below. The order of the learned trial judge is set aside. Deposit is refunded to the appellant.